

Your VESTED



INTEREST

North Dakota State Investment Board

March 2005

CAN THE "MARKET" BE BEATEN?

The market? What market? Ever had someone come up to you and ask what the market did today? Chances are, if you knew, you would tell them how the Dow Jones Industrial Average (DJIA) fared for the day. And they would be satisfied with your response, now confident that they knew how the market did. Many people are not aware that the DJIA is a proxy for only large U.S. corporate stock performance and does not address many other sectors of the "market," such as stocks of smaller companies, much less bonds and other investment instruments.

The DJIA is the average of the returns of only 30 stocks, so most pension funds and other institutional investors look to indices with more representation such as the Standard and Poor's Index of 500 stocks (S&P 500). While this index has many more companies in it than the DJIA, it is still just a measure of the big US companies (known in the biz as Large Cap Domestic Equity) and does not address other market segments. Knowing this, however, does induce some structure into the design of a portfolio.

In the cases of the TFFR and PERS funds, their respective Boards have identified Large Cap Domestic Equity as a market segment they want to be strategically invested in. This tells the State Investment Board (SIB) that some specified percentage of these funds should be invested in these types of securities. It is up to the SIB to figure out the best approach to investing in these corporate behemoths.

Looking back over many years, there is no doubt that SIB investments in Large Cap Domestic Equity have sometimes taken their licks. Often times, there were some managers who seemed to have a difficult time doing as well as the market, much less beating it. As a result of this experience, the SIB took a direction to reduce active management risk and tie returns more closely to the underlying index. By reducing risk, we don't expect the portfolio to "hit home-runs," but by the same token, it should be capable of generating plenty of singles and doubles, which add some margin of return over the index.

Since adopting this approach, the Large Cap Domestic Equity portfolio has performed well relative to the universe of public pension plan sponsors and the S&P 500 Index. For the last one, two, and three year periods, this segment has performed in the top quartile of the relevant universe. For the four years since implementation, the asset class ranks in the top 27 percent of the same universe.

Good performance with risk control in place is helpful to a good night's sleep!

State Investment Board

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*Steve Cochrane, CFA
Executive Director/CIO*

FROM THE DIRECTOR'S CHAIR

ONE SIZE DOES NOT FIT ALL

The featured article in this newsletter addresses investments by the SIB in the asset class we refer to as "Large Cap Domestic Equity," or stocks in big American companies. As you may have read, the SIB has taken a risk averse approach to this investment type, avoiding the use of managers that take positions that are largely diverse from the index we use for benchmarking.

As you probably already know, the Pension Trust, in which the PERS and TFFR invest, actually has ten distinct asset classes. Life would be simple if the investment approach in each asset class were the same and we expected to succeed with such a streamlined strategy. Well folks, it just ain't so. And that's one of the reasons why the SIB meets monthly for several hours to implement the various strategies used across these many asset classes.

In some cases, the distinctions are obvious. Take for example the intuitive understanding that investing in real estate is different than stock market investing. Buildings you can touch and feel, occupants and rental income you can count, and contracts you can read, give way to an investment approach a bit different than say, the analysis of a company with a seemingly great idea for a product that may or may not work once put into production.

In addition to the apparent differences between the various investment types, one must consider the

historical track records of managers' abilities to outperform the indexes that measure these asset classes. If most managers beat the benchmarks in an asset class over time, then it becomes more attractive to consider an active management approach within that category. The underlying assumption, of course, is that the added dimension of active decision making will enable the SIB to outperform the relevant benchmark.

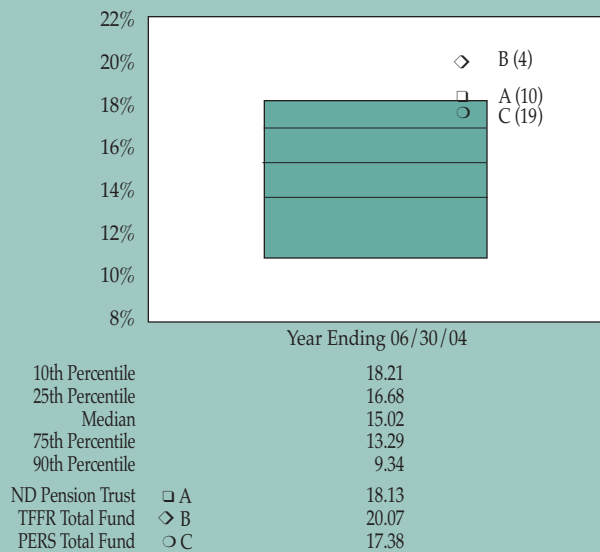
In Large Cap Domestic Equity, it seems that about half the managers can be expected to outperform the S&P 500 over time. With the odds about 50/50, you still must consider that you pay higher fees to active managers that also must be netted against performance. This begins to tilt the scale away from active management. In contrast, consider investment in the asset class we call, "International Fixed Income," or investing in the bonds of foreign entities. History shows that over the last ten years, 96 percent of managers have outperformed the index benchmark for this asset class. Over the last five years, 83 percent have outperformed, as have 82 percent for the last three years. Obviously, this creates an environment that suggests active management.

Across our ten asset classes, this relationship varies and an array of differing opportunities is presented. The job of the SIB is to work to position our investments to benefit from these environmental factors, and this is also part of the fun!

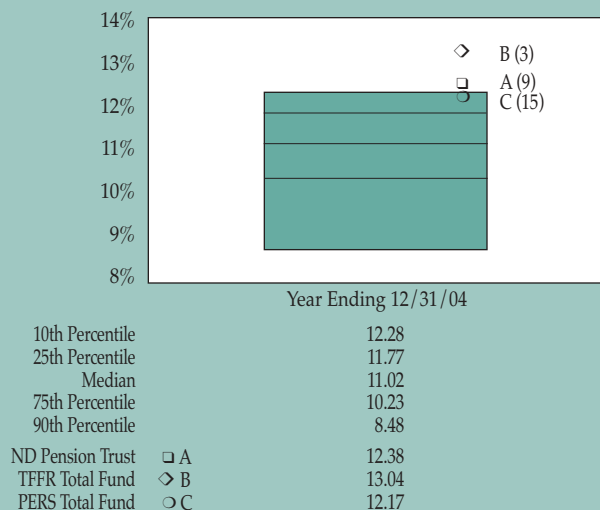
PERFORMANCE IN 2004

The floating bar charts compare the TFFR, PERS and Pension Trust's gross performance to a large universe of similar funds. As you can see, returns remain relatively strong for the calendar year, as they did for the past fiscal year. For the calendar year, the TFFR fund ranks in the top 3 percent of funds while PERS is in the top 15 percent.

Total Fund Rankings Compared to Callan Database for Year Ended June 30, 2004



Total Fund Rankings Compared to Callan Database for Year Ended December 31, 2004



SIB CHANGES



Kelly Schmidt



Clarence Corneil

State Treasurer Kelly Schmidt will serve as an ex officio member of the SIB. Her current term in office ends December 31, 2008. Clarence Corneil represents TFFR on the SIB. His current term on the TFFR Board ends June 30, 2007.



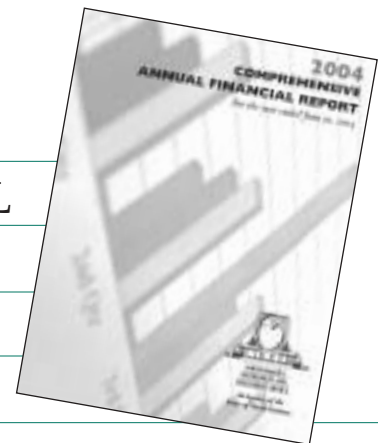
Kathi Gilmore



Paul Lofthus

Special thanks to former State Treasurer Kathi Gilmore and Paul Lofthus for their years of dedicated service to the State Investment Board. Good luck in your future endeavors.

2004 ANNUAL FINANCIAL REPORT AVAILABLE



The North Dakota Retirement and Investment Office Comprehensive Annual Financial Report (CAFR) may be viewed from our website, www.discovernd.com/rio or a copy may be requested by contacting the administrative office. This report is a complete review of the financial, investment, and actuarial conditions of the State Investment Board and the Teachers' Fund for Retirement.

JUST WHO IS RIO?

Established in 1989, the Retirement and Investment Office's (RIO) governing body is the State Investment Board (SIB). The SIB has the authority to establish an office and retain appropriate staff to administer the retirement and investment programs.

As the administrative agency, RIO is charged with providing and coordinating the administrative activities of the SIB and the Teachers' Fund for Retirement (TFFR).

At its inception, RIO had a staff of 19 full-time employees. While expanding services and programs through efficiencies and new technologies, the office is currently staffed by 17 full-time employees.



North Dakota Retirement and Investment staff.

The Retirement and Investment Office website contains a wealth of data for the investment programs administered by the State Investment Board including the Public Employees Retirement System, the Teachers' Fund for Retirement and the Workforce Safety & Insurance Fund.

Don't miss the opportunity to check out the investment performance, asset allocation, and investment guidelines at

www.discovernd.com/rio

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